Insolvency and the Arbitration Agreement – A Closer Look at *Founder Group (Hong Kong) Limited (in liquidation) v Singapore JHC Co Pte Ltd*

Introduction

The players may change but the story is always the same – the debt that is due and owing arises out of documents which contain an arbitration agreement. In such a scenario, should the claimant pursue winding-up proceedings in court or commence an arbitration?

In *Founder Group (Hong Kong) Limited (in liquidation) v Singapore JHC Co Pte Ltd* [2023] SGCA 40 (***Founder Group***), the Singapore Court of Appeal (**CA**) clarified the test it had set out in the earlier decision of *AnAn Group (Singapore) Pte Ltd v VTB Bank (Public Joint Stock Co)* [2020] 1 SLR 1158 (***AnAn***) when dealing with a matter where the claimant asserts that it is a creditor of the defendant based on a debt arising out of a contract containing an arbitration agreement, and the defendant disputes that debt or raises a cross-claim arising out of the contract.

Significantly, the CA clarified that the test in *AnAn* is relevant not only to the question whether a winding-up application should be granted, but also to the question whether the claimant has standing as a creditor to bring a winding-up application. The CA also made important findings on who is a contingent creditor, and gave guidance on how inconsistent positions taken by parties could adversely impact their arguments on whether the debt is subject to an arbitration agreement (and consequently, subject to the test in *AnAn*).

The Test in *AnAn*

To recap, the CA in *AnAn* held that, when a winding-up application is premised on a debt subject to arbitration, the *prima facie* standard – as opposed to the triable issue standard – of review applies. The court must consider whether:

(a) There is an arbitration agreement between the parties that appears *prima facie* to be valid;

(b) The dispute or cross-claim which the defendant raises appears *prima facie* to fall within the scope of the arbitration agreement; and

(c) Upon considering factors which do not relate to the merits of the dispute in respect of the debt or of the cross-claim, the court is satisfied that the defendant is not abusing the court's process by raising the dispute or cross-claim.

The High Court's Decision and the Parties' Cases on Appeal

The appeal in *Founder Group* was against the decision of the General Division of the High Court (**High Court**) to dismiss the winding-up application brought by the appellant, Founder Group (Hong Kong) (in liquidation) (**FGHK**), against the respondent, Singapore JHC Co Pte Ltd (**JHC**).

FGHK claimed that it was a creditor of JHC for approximately US$47 million due under contracts between the parties (**Contracts**) and maintained that JHC was unable to pay its debts and/or that it would be just and equitable for JHC to be wound up. Although the High Court accepted that JHC was unable to pay its debts, it found that FGHK failed to establish its standing as a creditor because the debt it relied on for the winding-

up application was disputed by JHC and subject to a valid arbitration agreement. Thus, the test in *AnAn* applied, and the requirements were satisfied on the facts.

The High Court also went on to consider the merits of FGHK's winding-up application, on the assumption that FGHK had standing as a creditor. It accepted that, based on JHC's audited financial statements, JHC was unable to pay its debts. It also rejected the alternative ground for the winding-up application – the just and equitable ground – since FGHK had not proved that its interests as a creditor were adversely affected by the alleged lack of probity in the conduct of the company's affairs.

On appeal, both parties accepted that the test in *AnAn* applied, but diverged on the question of whether the requirements had been satisfied.

FGHK argued that that it had standing to present the winding-up application as a creditor, or alternatively as a contingent creditor under section 124(1)(c) of the Insolvency, Restructuring and Dissolution Act 2018 (**IRDA**). In this regard, FGHK submitted that the test in *AnAn* related only to whether it should succeed in its winding-up application, and not to whether it had standing to present such an application. FGHK also argued that JHC's dispute over the debt was an abuse of process and that the third *AnAn* requirement was therefore not met. Additionally, FGHK contended that JHC had not provided clear and convincing evidence to displace its documented admission of the debt. Finally, FGHK argued that it would be just and equitable for JHC to be wound up.

JHC, on the other hand, argued that the High Court was correct in finding that the *AnAn* requirements were satisfied and that FGHK had not established that it was a creditor. Further, FGHK was not even a contingent creditor since the debt had to be determined in arbitration. FGHK also argued that the high threshold for establishing abuse of process in the *AnAn* test had not been met, and that there was no basis for it to be wound up on just and equitable grounds. Additionally, JHC took the position that the payment obligation in the Contracts was never meant to be enforced, and that the Contracts were null and void.

The CA's Decision

Finding in favour of FGHK, the CA allowed its appeal and granted the winding-up application.

Test in AnAn is applicable to determine the issue of standing

The CA held that, if there is an arbitration agreement between the parties, the test in *AnAn* is relevant to both the question of whether the winding-up application should be granted and the question of standing to bring the winding-up application.

The starting point is to consider a debt under a contract that does not contain an arbitration agreement. When a winding-up application is premised on such a debt, a finding that the debtor disputes the debt in good faith and on substantial grounds (i.e., there are triable issues) means that the claimant has no standing as a creditor to present a winding-up application.

However, when the winding-up application is premised on a debt subject to an arbitration agreement and the debt is disputed, the claimant cannot claim to have status as a creditor until the dispute has been resolved by arbitration in his favour. Accordingly, where a debt is subject to a dispute that *prima facie* falls within the scope of an arbitration agreement that appears *prima facie* to be valid (i.e., the first and second *AnAn* requirements are satisfied), the claimant has not established its standing as a creditor – in the same way that a claimant who relies on a debt (which is not subject to arbitration) that is disputed in good faith

and on substantial grounds has not. As observed by the CA in *AnAn*, the insolvency regime is not engaged at the point when a dispute arises in relation to a debt subject to an arbitration agreement.

FGHK was not a contingent creditor

The CA held that FGHK was not a contingent creditor under section 124(1)(c) of the IRDA. Noting that the term "*contingent creditor*" is not defined in the IRDA, the CA relied on the definition set out in *Re William Hockley Ltd* [1962] 1 WLR 555 (***Re William Hockley***) and subsequently adopted by the High Court in *Re People's Parkway Development Pte Ltd* [1991] 2 SLR(R) 567 (***People's Parkway***):

> *The expression 'contingent creditor' is not defined in the Companies Act 1948, but must, I think, denote a person towards whom under an existing obligation, the company may or will become subject to a present liability on the happening of some future event or at some future date.*

The CA held that there was nothing contingent in this case as the very existence of the payment obligation was in dispute. This was because JHC's position was that the payment obligation was never meant to be enforced and the Contracts were null and void. What the parties had was a disputed liability, and not an existing and present obligation which would or might become payable on a future event.

The CA also rejected FGHK's reliance on the High Court's decision in *RCMA Asia Pte Ltd v Sun Electric Power Pte Ltd (Energy Market Authority of Singapore, non-party)* [2020] SGHC 205 (***Sun Electric (HC)***) to support its argument that it was a contingent creditor. In *Sun Electric (HC)*, the High Court referred to the definition of "*contingent creditor*" in *Re William Hockley* and noted that, under the defendant's obligations in its agreement with the plaintiff, the defendant might "*become subject to a judgment debt*" upon the pending suit being decided in favour of the plaintiff. On that basis, the High Court held that the plaintiff was a contingent or prospective creditor. While the decision was subsequently appealed against, the issue on the plaintiff's standing was not raised before the CA as the parties did not dispute it (see *Sun Electric Power Pte Ltd v RCMA Asia Pte Ltd (formerly known as Tong Teik Pte Ltd)* [2021] 2 SLR 478).

In *Founder Group*, with the issue of standing squarely before the court, the CA took the opportunity to clarify that the High Court's observations in *Sun Electric (HC)* were incorrect and should not be followed. Although the High Court had referred to the same definition of "*contingent creditor*" in *Re William Hockley* and *People's Parkway*, its interpretation of the term "*existing obligation*" was unduly broad as it included a claim for damages for breach of contract even if the liability was disputed by the defendant company and subject to pending proceedings.

The CA further explained that a disputed liability could in principle be considered a contingent liability if the liability itself is not in dispute, but rather, the dispute goes to whether the contingent event had occurred such that the liability had crystallised.

On the facts of *Founder Group*, FGHK was not a contingent creditor. The CA noted that, if FGHK failed in its primary claim that it was a creditor in the sum of US$47 million, JHC would have no liability at all because JHC would have succeeded in challenging the very existence of liability. That liability was not contingent because it was not a present liability payable upon a future event taking place. The CA further stated that, even if FGHK had brought proceedings and succeeded in establishing that JHC was wrong, that would not be a contingency within the meaning of section 124(1)(c) of the IRDA, but was simply the outcome of the process that the parties had to follow to resolve their dispute.

Test in AnAn was not applicable

The CA held that the test in *AnAn* was not applicable to the present case, given the position taken by JHC.

JHC had argued that the debt under the Contracts was not payable because they were not meant to be enforced, and therefore null and void under Chinese law. JHC had also argued that the Contracts were sham transactions. The CA held that, since JHC's position was that there had never been any intent on its part to enter into the Contracts or to be bound by any of the obligations set out therein, this would logically include the arbitration agreements. This was manifestly inconsistent with JHC's attempt to now rely on the arbitration agreements to oppose the winding-up application.

Notably, the High Court had taken a different view on the basis that the doctrine of separability operated to prevent a party from evading an obligation to arbitrate by denying the existence or validity of the contract containing the arbitration agreement. In this regard, the High Court considered that, where a party alleges that a contract containing an arbitration agreement is null and void, the arbitration agreement continues *prima facie* to be valid and enforceable, unless and until a duly constituted arbitral tribunal finds that the contract is indeed null and void.

On appeal, the CA held that the High Court had erred in the application of the doctrine of separability. The Contracts were likely governed by Chinese law and there was no proof before the CA that, under Chinese law, the doctrine of separability indeed operated to enable JHC to invoke the arbitration agreements notwithstanding its assertion that the Contracts in which they were contained were null and void. As such, the CA considered the matter under Singapore law. As a matter of Singapore law, a party is not entitled to invoke an arbitration clause contained in a contract which that party maintains is not valid or binding. The CA further observed that, when a party challenges the validity of the underlying contract, it is crucial to determine if the challenge is also an attack on the arbitration agreement. This is a fact-sensitive exercise and will depend on the nature of the challenge being raised.

The CA noted JHC's position that the Contracts were null and void, and also that JHC had not put into evidence any explanation as to whether the arbitration agreement survived or that the parties intended to be bound by it. As such, the CA held that JHC could not invoke the arbitration agreement and consequently the test in *AnAn* was not applicable.

JHC should be wound up

The CA ordered that JHC be wound up. In coming to this decision, the CA found that the debt was due and owing, and that JHC had not raised substantial grounds to dispute the debt.

While JHC argued that the Contracts were not meant to be enforced and were therefore null and void, JHC had not provided any explanation why that was their case. In this regard, JHC had not explained why it claimed that the Contracts were not meant to be enforced or why the Contracts had been entered into at all.

The CA also took into account various audit confirmation requests that confirmed the debt and showed that the debt had consistently been carried in JHC's books and accounts. This had formed the basis of the High Court's holding that JHC was unable to pay its debts, and this finding was not challenged by JHC on appeal.

In the circumstances, the CA allowed the appeal and ordered that JHC be wound up.

Key Takeaways

The decision in *Founder Group* presents as an interesting case study for insolvency and arbitration practitioners alike. We set out below some key observations and strategic considerations in cases where the debt is subject to an arbitration agreement.

For creditors:

(a) At the outset, when you are considering whether to pursue any debt that may be subject to an arbitration agreement, the first step is to determine whether the arbitration agreement appears *prima facie* to be valid. This will then guide you on which path to take: to pursue a winding-up application or commence an arbitration.

(b) If the arbitration agreement appears *prima facie* to be valid, this could potentially affect your standing as a creditor and/or the question of whether your winding-up application should be granted under the test in *AnAn*. If you intend to proceed with a winding-up application on the basis of a debt arising from an underlying contract which contains an arbitration agreement, you should ensure that any argument you raise to attack the validity of that arbitration agreement does not undermine the underlying contract from which the debt arises and/or the defendant's payment obligation.

(c) It would be good to compile and produce compelling evidence to show that the debt is indeed due and owing, and that the winding-up application does not amount to an abuse of process. For instance, it may be helpful to procure the defendant's audited financial statements and other financial documents such as audit request confirmations. If there is a debt due and owing solely based on these documents, this could form the basis for winding-up, without having to refer to an underlying contract. This can be seen from *Founder Group* as described above, as well as the CA's decision in *Fustar Chemicals Ltd (Hong Kong) v Liquidator of Fustar Chemicals Pte Ltd* [2009] 4 SLR(R) 458 where the CA held that a creditor may prove its debt by referring to financial statements and accounts which consistently acknowledged and recorded the debt. The High Court in *Feima International (Hongkong) Ltd (in liquidation) v Kyen Resources Pte Ltd (in liquidation) and others* [2022] SGHC 304 also took into account audited financial statements in finding that a proof of debt should be admitted. While the two latter cases deal with challenges by creditors against the liquidator's decisions to reject their proofs of debt, they signal the weight that the court may be persuaded to place on audited financial statements in evidencing that a debt is due and owing.

(d) Be certain of your standing as a creditor or a contingent creditor. As observed in *Founder Group*, these positions are internally inconsistent: either the debt relied on is presently due (in which case you are a creditor), or the debt will become due upon the happening of some future event (in which case you are a contingent creditor).

For debtors:

(a) The creditor's standing to bring winding-up proceedings is a relevant factor to consider when deciding the dispute resolution clause in your agreements. A *prima facie* valid arbitration agreement could delay the commencement of winding-up proceedings by your creditors. For a debtor company, this means avoiding unwanted publicity and minimising cause for concern for other creditors. That being said, this should not be the only relevant consideration; you should also take into account factors such as service and enforceability when determining the mode of dispute resolution in your agreements.

(b) If you are faced with winding-up proceedings and intend to rely on the arbitration agreement in the underlying contract to stay the winding-up proceedings, you should ensure that your position on the underlying contract does not compromise the validity of the arbitration agreement. If you intend to challenge the underlying contract but preserve the arbitration agreement, you may consider first commencing an arbitration, and then bringing that to the attention of the winding-up court.

(c) If you are part of a group of companies with intercompany loans, you should keep track of how the loan amounts are recorded in your audited financial statements. If an intercompany loan is consistently recorded in multiple audited financial statements, the court may find that the debt is due and owing, and a creditor may rely on it as grounds to wind up the debtor company. As such, also ensure that there are explanations recorded either in the audited financial statements or in contemporaneous documents regarding any such intercompany loan, and especially when the loan is supposed to be repaid. This will allow the debtor company to explain to the court (if faced with a winding-up application) that, although the loan is recorded in multiple audited financial statements, the agreement between the related companies is that the loan need not be repaid immediately or upon demand, and that there are other terms and conditions attached to the loan.

If you would like information and/or assistance on the above or any other area of law, you may wish to contact the Partner at WongPartnership whom you normally work with or any of the following Partners:

Adnaan NOOR
Partner – Restructuring & Insolvency and Special Situations Advisory
d: +65 6416 2477
e: adnaan.noor@wongpartnership.com
Click here to view Adnaan's CV.

Eden LI
Partner – Restructuring & Insolvency and Special Situations Advisory
d: +65 6517 3766
e: eden.li@wongpartnership.com
Click here to view Eden's CV.

Connect with WongPartnership.

WPG MEMBERS AND OFFICES

- contactus@wongpartnership.com

SINGAPORE

-
WongPartnership LLP
12 Marina Boulevard Level 28
Marina Bay Financial Centre Tower 3
Singapore 018982
t +65 6416 8000
f +65 6532 5711/5722

CHINA

-
WongPartnership LLP
Shanghai Representative Office
Unit 1015 Link Square 1
222 Hubin Road
Shanghai 200021, PRC
t +86 21 6340 3131
f +86 21 6340 3315

INDONESIA

-
Makes & Partners Law Firm
Menara Batavia, 7th Floor
Jl. KH. Mas Mansyur Kav. 126
Jakarta 10220, Indonesia
t +62 21 574 7181
f +62 21 574 7180
w makeslaw.com

MALAYSIA

-
Foong & Partners
Advocates & Solicitors
13-1, Menara 1MK, Kompleks 1 Mont' Kiara
No 1 Jalan Kiara, Mont' Kiara
50480 Kuala Lumpur, Malaysia
t +60 3 6419 0822
f +60 3 6419 0823
w foongpartners.com

MIDDLE EAST

-
Al Aidarous Advocates and Legal Consultants
Abdullah Al Mulla Building, Mezzanine Suite 02
39 Hameem Street (side street of Al Murroor Street)
Al Nahyan Camp Area
P.O. Box No. 71284
Abu Dhabi, UAE
t +971 2 6439 222
f +971 2 6349 229
w aidarous.com

-
Al Aidarous Advocates and Legal Consultants
Oberoi Centre, 13th Floor, Marasi Drive, Business Bay
P.O. Box No. 33299
Dubai, UAE
t +971 4 2828 000
f +971 4 2828 011

PHILIPPINES

-
Gruba Law
27/F 88 Corporate Center
141 Valero St., Salcedo Village
Makati City 1227, Philippines
t +63 2 889 6060
f +63 2 889 6066
w grubalaw.com

wongpartnership.com